

VZCZCXRO8485  
PP RUEHDBU  
DE RUEHTA #1240/01 1280728  
ZNY CCCCC ZZH  
P 080728Z MAY 07  
FM AMEMBASSY ASTANA  
TO RUEHC/SECSTATE WASHDC PRIORITY 9390  
INFO RUCNCIS/CIS COLLECTIVE 0154  
RUCPDOG/DEPT OF COMMERCE WASHDC  
RUEAIIA/CIA WASHDC  
RUEBAAA/DEPT OF ENERGY WASHDC

C O N F I D E N T I A L SECTION 01 OF 02 ASTANA 001240

SIPDIS

NOFORN  
SIPDIS

DEPT FOR EB/ESC; SCA/CEN (O'MARA)

E.O. 12958: DECL: 05/07/2017

TAGS: [ENRG](#) [EPET](#) [KZ](#)

SUBJECT: KAZAKHSTAN: PRIME MINISTER DISCUSSES OIL SECTOR  
DEVELOPMENT STRATEGY, AUDITS OF CONTRACT COMPLIANCE

REF: A. ASTANA 684  
[1](#)B. ASTANA 908  
[1](#)C. ASTANA 848  
[1](#)D. ASTANA 443  
[1](#)E. 06 ASTANA 738  
[1](#)F. 06 ASTANA 501

Classified By: Ambassador John Ordway; reasons 1.5(b) and (d).

[1](#)1. (C) Summary: In back-to-back April 26-27 conversations with Commercial and Business Affairs Special Representative (S/R) Frank Mermoud and the Ambassador, Prime Minister Masimov discussed his government's strategy for developing Kazakhstan's oil and gas sector, its intent to audit existing subsoil users for compliance with their contracts, and its plan to review all (historical) privatization deals, to ensure that beneficiaries have fulfilled their contractual obligations. Masimov confirmed that action on the "N Block" (Ref A), as well as all other oil tenders, has been suspended, "for a maximum of six months," while the Kazakhstani government figures out how to leverage the deals to achieve economic diversification and to increase value-added in hydrocarbon production. In an April 26 conversation with S/R Mermoud, Masimov's Advisor Yerlan Sagadiyev added that a lack of oil and gas transportation routes rendered further development of the Caspian problematic. A Kazakhstani government initiative to select thirty domestic corporations as "national champions" and entrust them with large-scale investment projects as a means of spurring economic diversification will be reported septel. End summary.

New Oil Project Negotiations Suspended -- Six Months Maximum  
-----

[1](#)2. (C) On April 27, Masimov elaborated on his April 9 conversation with the Ambassador (Ref B), telling the latter that the GOK had temporarily suspended action, not only on "N Block" negotiations, but on all ongoing oil tender negotiations. (Including, presumably, ExxonMobil's efforts to secure rights to onshore acreage -- Ref C.) The suspension would last "six months maximum," Masimov assured the Ambassador, while the GOK figured out how to leverage the tender process to achieve economic diversification and capture more value-added from hydrocarbon production. (On April 17, Energy Minister Izumukhambetov commented publicly on one way in which this might be achieved, suggesting that the GOK might amend the hydrocarbon legislation to obligate subsoil users to construct refineries and other processing facilities. The current, 2005 Production Sharing Agreement law indicates that bidders who undertake such projects will get preference in the allocation of offshore assets, but

stops short of requiring them.) The Ambassador observed that, if not carefully administered, such a policy could lead to the construction of "uneconomic" projects -- subsidized, in effect, by the production of crude oil. Masimov acknowledged the point.

¶3. (C) On April 25, Yerlan Sagadiyev, Masimov's Advisor, painted a somewhat starker picture of the GOK's latest thinking in a meeting with S/R Mermoud. "The problem," he explained, is that the government "has too much money" that it pours into a broad range of sectors, such as energy, telecommunications, and healthcare. This, Sagadiyev continued, creates an unpredictable environment for the private sector, "scaring it away" and causing it to invest abroad. Sagadiyev made clear what the government sees as the culprit: "we've got a mess with oil and need to figure things out." Further development of the oil sector in any case looks problematic, he added, as the infrastructure for transporting oil, "such as roads and port terminals," is lacking. Moreover, Sagadiyev quoted President Nazarbayev as saying "I don't think we can do the Caspian without Russia." Finally, Sagadiyev added, no one knows how ecologically dangerous off-shore drilling really is. "Too many people from the U.S.," he concluded, "come to Kazakhstan and say 'Drill more, build more pipelines.' But it is not possible to do this."

#### Reviewing Privatization Deals and Subsoil Contracts

-----

¶4. (C) Masimov briefed the Ambassador on two additional GOK initiatives to ensure that the state's interests were respected by private sector entities. First, the GOK would

ASTANA 00001240 002 OF 002

review all past privatization deals in which the beneficiary had agreed to perform certain obligations -- for example, to create a certain number of jobs, or invest a defined quantity of money -- to see if the buyer had, indeed, performed those obligations. Second, the GOK would review all subsoil use agreements, again to ensure that the contract terms were being respected.

¶5. (C) While the GOK's intended review of privatization deals has not (yet) been publicized, Masimov has spoken publicly about the initiative to review subsoil contracts, and several Western oil companies have already experienced what they believe to be its effects. In some contexts Masimov has focused his criticism on companies which obtain subsoil licenses but fail to invest and develop the field according to the agreed-upon schedule, presumably because the license-holders' interests are speculative, and their intent is to "flip" the asset rather than develop it. (The GOK recently passed legislation to stem this trend -- Ref D -- but appears to be making this issue a focus of its contract audits as well.) In the same context, Masimov has also alluded publicly to the production delays and cost overruns bedeviling Kashagan field development (Ref E), perhaps laying the groundwork for a GOK attempt to penalize Kashagan partners for the disappointing results -- a battle which the Kashagan partners believe could happen as early as late summer, on the occasion of a broad project review. Masimov has also pledged publicly to enforce contractual obligations to protect the rights, including wage equality, for Kazakhstani employees of foreign companies and joint ventures -- a hot topic, especially in the oil and gas sector, since the October 2006 "Tengiz riot" (Ref F). (ConocoPhillips, for one, recently underwent a full-scale audit of its labor practices.)

¶6. (C) The other area of recent increased GOK scrutiny has been in the area of environmental compliance. TengizChevrOil's (TCO) April 4 signature of a three-year, \$800 million environmental spending plan against the backdrop of Ministry of Environment threats to revoke TCO's operating

license is only the most-publicized example. ExxonMobil's Government Relations Director, Patty Graham, told Energy Officer on April 25 that ExxonMobil has seen "a vast increase" in Environmental Ministry activity in 2007. Other subsoil users -- CNPC Aktobemunaigas, KazakhOil Aktobe, Karachaganak Petroleum Operating Company, Karazhanbasmunai, PetroKazakhstan Kumkol Resources -- have all been cited in recent cases, most of which have been announced in the press.

17. (C) Several oil industry analysts have taken the GOK's initiative to review subsoil contracts as a sign of its intent to maximize GOK revenue and force a revision of contracts which may have been signed on terms less favorable to the government than prevail in today's market for the country's oil assets. Masimov, however, has been careful to underscore the GOK's respect for contract sanctity. On April 24, for example, when summing up his government's first 100 days, Masimov declared that, "should both parties to a contract be fulfilling it, the contract will not be revised."

18. (U) This cable has been cleared by S/R Mermoud.  
MILAS